

ATTACHMENT A

POOLED BOND PROGRAM

BACKGROUND & AUTHORITY

The Virginia Public School Authority (the "VPSA") was created by the General Assembly of Virginia in 1962, Chapter 11, Title 22.1, Code of Virginia, 1950, as amended, for the purpose of supplementing the existing methods of financing capital projects for public schools in the counties, cities, and towns of the Commonwealth. The other three significant sources of capital financing available to localities are loans from the Literary Fund, locality bonds and locality appropriations.

The VPSA is governed by a Board of Commissioners (the "Board"), consisting of the State Treasurer, the State Comptroller, the Superintendent of Public Instruction, and five additional members appointed by the Governor, subject to confirmation by the General Assembly, who serve at the pleasure of the Governor. The Governor designates one of the appointed members of the Board as the Chairman, who serves as chief executive officer of the VPSA. The VPSA is staffed by the Department of the Treasury.

The VPSA provides financing to localities through the sale of its bonds. With the proceeds of its bonds, the VPSA purchases a predetermined "pool" of general obligation bonds from localities. The VPSA issues bonds for its pooled bond program under different bond resolutions.

The VPSA currently issues bonds for its pooled bond program under the 1997 Resolution. The Virginia Public School Authority Board of Commissioners adopted the 1997 Resolution on October 23, 1997. The 1997 Resolution allows the Authority to continue its traditional long-term financing programs while also providing intermediate-term equipment financing to local school divisions. Used for the first time in connection with the Fall 1997 sale, the 1997 Resolution carries with it ratings of AA+, Aa1 and AA+ from Fitch, Moody's and Standard & Poor's ratings services respectively. The 1997 Resolution is secured first from payments on the local general obligation school bonds purchased with the proceeds of, or transferred in connection with a refunding effected by, bonds issued under the 1997 Resolution. If any local issuer fails to make timely payment of debt service on its local school bonds and the application of the State Aid Intercept provisions of the Virginia Code § 15.2-2659 does not remedy the deficiency, then the 1997 Resolution bonds will be payable from sum sufficient appropriations first from available funds in the Literary Fund and then from the general fund of the Commonwealth.

In its discretion and based on the amortization structures requested by all the localities participating in the sale, the VPSA may pay the localities purchase prices other than par for their local school bonds. The purchase prices paid, whether par, premium or discount, would be intended to allocate fairly the issuance costs associated with VPSA's bonds among the various local school bond structures, which may include, for example, 10-year final maturities and 20-year final maturities. Alternatively, VPSA may resize the local school bond issue to reflect the purchase premium or discount to produce the requested amount of proceeds.

ADVANTAGES TO LOCALITIES

It is the objective of the VPSA financing programs to make financing available to all localities in the Commonwealth in a manner that:

- provides market access to those localities which do not have ready access;
- provides low cost financing to localities needing assistance;
- maintains the high credit quality of the VPSA financing program - thus ensuring that the lowest possible interest rates are obtained; and
- provides a “user friendly” financing vehicle to localities by decreasing administrative time required by local officials for initial issuance, arbitrage rebate compliance, and continuing disclosure obligations.

The VPSA offers market access on a predictable basis for localities while most of the administrative costs associated with issuing the bonds are covered by the VPSA. Finally, under State law, localities do not have to obtain voter approval for bonds sold to the VPSA unless their charter dictates otherwise.

DISPOSITION OF BOND PROCEEDS

Under the provisions of the VPSA's enabling act, it issues bonds, the proceeds from which are used to purchase general obligation local school bonds issued by counties, cities and towns of the Commonwealth of Virginia under the provisions of the Public Finance Act for the purpose of financing capital projects for public schools.

Due to arbitrage restrictions and rebate management requirements imposed by the Internal Revenue Code of 1986, as amended (the "Code"), the proceeds from all VPSA financings which are used to purchase the locality bonds, are invested in the State Non-Arbitrage Program ("SNAP") (see "State Non-Arbitrage Program" herein), pursuant to the provisions of a Proceeds Agreement among each participating locality, the VPSA, an investment manager, a depository and the other participating localities.

Through SNAP, the investment manager executes the investment of local school bond proceeds to ensure compliance with tax regulations as well as optimization of proceeds earnings. The depository disburses funds upon the receipt of requisitions. Separate accounts and sub-accounts are maintained and managed for each locality. Finally, the VPSA arranges for, and pays the costs associated with, the calculation of the rebate requirement for each locality pursuant to the Code. Each locality, however, is responsible, pursuant to the Proceeds Agreement for the payment of its rebate liability to the Internal Revenue Service.

PARTICIPATION IN THE POOLED BOND PROGRAM

To apply for financing, a locality must submit an application form to the VPSA, and its school board must adopt a resolution authorizing the locality to apply to the VPSA for financing. Additionally, given the complexities of completing a bond financing, localities are required to procure a qualified bond counsel on or before the due date of the enclosed application.

The VPSA will distribute a Bond Sale Agreement and associated documentation to localities which submit applications for inclusion in the financing.

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BONDS ISSUED AND PERFORMANCE

The localities' yield for 20 year bonds purchased by the VPSA in prior pooled financings under the various resolutions were as follows:

<u>Dated Date</u>	<u>Series</u>	<u>Resolution</u>	<u>Local School Bond Yield</u>
April 1996	1996A	1991	5.55%
November 1996	1996B	1991	5.34%
May 1997	1997A	1991	5.61%
November 1997	1997-I	1997	5.15%
April 1998	1998A	1997	4.92%
November 1998	1998B	1997	4.72%
May 1999	1999A	1997	4.69%
November 1999	1999B	1997	5.64%
May 2000	2000A	1997	5.48%
November 2000	2000B	1997	5.20%
May 2001	2001A	1997	4.94%
November 2001	2001 B	1997	4.49%
May 2002	2002 A	1997	4.70%
November 2002	2002 B	1997	4.21%
May 2003	2003 A	1997	4.09%
November 2003	2003 C	1997	4.23%
May 2004	2004 A	1997	4.20%
November 2004	2004 B	1997	4.01%
May 2005	2005 C	1997	4.15%
November 2005	2005 D	1997	4.23%
May 2006	2006 A	1997	4.43%

STATE AID INTERCEPT

BACKGROUND & AUTHORITY

In 1988, the General Assembly amended Section 15.2-2659 of the Code of Virginia, known as the State Aid Intercept Provision (the "Provision"), to redirect, upon proof of a locality's default in the payment of debt service on any of its general obligation debt, funds appropriated by the General Assembly and payable to such defaulting locality from such defaulting locality to the payment of debt service on its general obligation debt. The amendment enhanced the credit quality of general obligation bonds issued by local governments within the Commonwealth.

State aid withholding programs are used by several states as public credit enhancements which support debt issued by local governments. This form of enhancement is an inexpensive and effective way for the Commonwealth to assist localities in reducing borrowing costs. The program uses state aid entitlements as a form of guarantee that debt service obligations will be met if a locality cannot meet its repayment obligation on a general obligation debt. In the event of such a default, the Commonwealth would withhold sufficient aid to meet debt service and redirect those funds to the payment of bondholders.

ADVANTAGES TO LOCALITIES

The most prominent benefit of the Provision has been the formal recognition by Standard & Poor's ("S&P"), one of the three major bond-rating services, of the enhancement the Provision provides for general obligation bonds issued by local governments within the Commonwealth.

According to S&P, the Provision guarantees a minimum "A" rating to any general obligation bonds issued by local governments within the Commonwealth if the following criteria are met:

- demonstration that state aid subject to withholding received by the local government in each of the last five fiscal years has been at least 1.25 times future maximum annual general obligation debt service, and
- the bond issue must have a paying agent, trustee or similar representative acting in a fiduciary capacity to promptly inform the Commonwealth in the event of a default.

Moody's will assign the "A1" programmatic rating upon request by issuers that have demonstrated the following conditions have been met:

- demonstration that their state aid covers maximum annual debt service by approximately two times, and
- the bond issuer must document that they are utilizing a paying agent who will be responsible for timely notification of the Commonwealth in the event of a payment default.

A particularly significant implication of this rating floor is that all localities, regardless of size, current rating or debt issuing frequency, will have low-cost access to the capital markets. This improved market access will result in localities being able to issue debt at lower interest rates and with lower

transaction costs.

EXPLANATION OF INTERCEPT PROCESS

The Provision is triggered when a locality within the Commonwealth does not pay principal or interest on any of its general obligation indebtedness when due. Under the Provision, funds appropriated by the Commonwealth and payable to a locality will be used to pay any portion of general obligation debt service that the locality fails to pay. The Provision requires immediate action on the part of both the Governor and the State Comptroller, so that payment to bond holders will be made promptly. The State Treasurer, as designee, will act on behalf of the Governor to ensure the timely implementation of the Provision.

The interception of state aid to pay a defaulting locality's debt service is comprised of five steps. The following describes the sequence of actions to be taken to implement the Provision.

1. **File Affidavit with Governor:** Upon a default in the payment of debt service on general obligation bonds of localities within the Commonwealth, either a bondholder or the paying agent for the bonds must notify the State Treasurer, acting as agent for the Governor, by filing an affidavit. The affidavit should identify the issuer, the bond issue and the debt service payment in question.
2. **Summary Investigation by State Treasurer:** The State Treasurer will immediately confirm whether a default has occurred by contacting the paying agent for the bonds and the locality. The State Treasurer will determine the exact amount of the shortfall and identify to whom the intercepted funds should be delivered.
3. **State Comptroller Directed to Withhold and Pay State Aid:** The State Treasurer will immediately contact the State Comptroller and direct the State Comptroller to withhold and to pay state aid appropriated by the Commonwealth on behalf of the defaulting locality to the paying agent. As part of this direction, the State Treasurer will provide the State Comptroller with the amount of and payment directions for the funds.
4. **State Comptroller Writes Warrant:** The Comptroller will instruct the Manager of General Accounting to process a warrant to make the bond payment for the locality. The warrant will be delivered to the State Treasurer's Office.
5. **State Treasurer Makes Payment:** The State Treasurer will then make payment to the paying agent or the bondholders. As appropriate, payment can be made via wire transfer or physical check.

The State Treasurer will maintain contact with the locality to determine when it will be able to assume payment of debt service on its bonds. If specific conditions warrant, the State Treasurer (and the Governor) will take additional action to assist the locality and to ensure that debt service continues to be paid in a timely fashion. As bonds are paid and canceled, they will be delivered to the State Comptroller. The State Comptroller will return these bonds to the locality. After each debt service payment made by the State Comptroller on behalf of the defaulting locality, the Comptroller will notify the locality of the payment. Each time state aid is intercepted pursuant to the Provision, the State Comptroller will file a report with the Governor that describes the actions taken. Additionally, if the

Provision is used, the State Comptroller will prepare an annual report that summarizes all interceptions of aid, the current status and the date that each interception was resolved.

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STATE NON-ARBITRAGE PROGRAM

BACKGROUND & AUTHORITY

Due to arbitrage restrictions and rebate requirements contained in the Code, all participating localities are required to enter into a Proceeds Agreement with the other participating local units, the VPSA, a depository, and an investment manager providing for the custody, investment, and disbursement of the proceeds of the bonds. The Treasury Board of Virginia has established a program, as authorized by the Code of Virginia, to assist local governments with the investment and accounting of bond proceeds, in order to comply with rebate requirements of the Code. This program, called the State Non-Arbitrage Program, or SNAP, offers a viable and inexpensive method for the management of bond proceeds.

SNAP is maintained by the Treasury Board pursuant to Article 8, Chapter 24, Title 2.2, Code of Virginia 1950, as amended (the "SNAP Act"), to provide comprehensive investment management, accounting and arbitrage rebate calculation services with respect to proceeds of tax-exempt financings of Virginia issuers ("Participants") including the Commonwealth itself. SNAP currently provides a money market mutual fund (the "Fund") as a means for Participants to invest their proceeds, as well as individually managed portfolios where appropriate.

ADVANTAGES TO LOCALITIES

SNAP is designed to assist Participants in complying with certain arbitrage rebate requirements of the Code. Investments are purchased and investment documentation is maintained in accordance with requirements of the Code, and rebate calculations are prepared for all participants by a rebate calculation agent in a manner and at such times as to enable Participants to comply with these requirements.

By pooling the funds of many Participants, the Fund seeks to provide the following benefits:

1. Preservation of Principal - The Fund invests only in high quality instruments in which Participants are permitted by statute to invest their bond proceeds, and follows certain other investment policies designed to preserve capital.
2. Liquidity - Participants may withdraw funds at any time to pay for the costs of capital projects for which their bonds were issued.
3. Income - The Fund seeks to earn the highest income consistent with preserving principal and maintaining liquidity.
4. Convenience - Participants do not have to schedule investment maturities to meet

project draw schedules.

5. Professional Management - Fund investments are managed by an investment professional that follows both general economic and current market conditions affecting interest rates.
6. Diversification - Each participant in the Fund will own shares in a diversified portfolio of high quality instruments.
7. Accounting, Safekeeping and Separate Accounts - The Fund provides a system which accounts for each participant's investments in a manner compatible with local government accounting and auditing requirements, and does all of the bookkeeping and safekeeping associated with the ownership of securities.

EXPLANATION OF SNAP PROCESS

To participate in SNAP, a Participant must enact a resolution and submit it to the investment manager, along with a Program Registration Form. Thereafter an Account Registration Form must be completed and submitted prior to investing any funds. Funds are invested in the Fund by wire transfer of bond proceeds to the depository on the closing date.

Funds may be withdrawn from the Fund by wire transfer by calling the investment manager to initiate a requisition. Upon request, the investment manager will provide each participant with checks which the participant may make payable to any payee.

The Fund pays all of its expenses which are accrued daily as a deduction from income. The Fund has entered into arrangements for investment management, administration, legal, accounting, audit, and depository services and also pays for organizational costs. Certain program costs, including the fees of the rebate calculation agent and all costs associated with individual portfolios, must be paid by the individual participant.

The program is designed to invest exclusively the proceeds of tax-exempt borrowings by Participants. The investment manager will not accept for investment in the program other funds of Participants.

The Treasury Board has authorized the creation of an Advisory Board composed at least partly of participants in SNAP, to provide advice and assistance to the Treasury Board and the State Treasurer with respect to the administrative aspects of the program.

SNAP Program Information Statements are available upon request from:

PFM Asset Management LLC
State Non-Arbitrage Program
One Keystone Plaza, Suite 300
N. Front & Market Streets
Harrisburg, PA 17101

Phone: 800-570-SNAP

Internet Address: www.vasnap.com